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A WOMAN SHOPS IN A LOUIS VUITTON STORE IN DOWNTOWN SHANGHAI. PHOTO COURTESY OF BUSINESS INSIDER AUSTRALIA.

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Australia should focus on Asia’s millionaires – not its “middle class”

Australia’s corporate strategists and national economic planners are mesmerised by what they believe will be rich pickings from the growth of Asia’s middle class. But while the population estimates of Asia’s emerging middle class are impressively large, their disposable incomes are not.

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Asia's increasing demand for basic commodities has benefitted Australia's resources sector enormously but similar success stories for our non-resources sectors are not as obvious. The promise of a vast Asian middle class bracing to buy Australian products and services remains elusive and arguably not very profitable. Our market-entry strategies into the region need to be re-evaluated and we should examine more carefully which sub-set, if any, of the emerging Asian middle-class market we can serve profitably.

When Australians think of "middle class", we generally think of a mainstream with disposable incomes that – even at the lowest end – will provide food on the table, a regular holiday and at least one flat-screen TV. In reality, however, the lives of most of Asia's so-called middle classes are very different. Across emerging Asia – which has grown so dramatically over the past few decades – most households classified as "middle-class" have an annual income of only US$2,000–10,000. Even after adjusting for purchasing power parity, their standard of living despite their high aspirations is severely constrained by their limited budgets and is well below that of most Australians.

There is widespread misunderstanding about the real spending power of Asia's emerging middle class, partly because demographic analysts use such a wide range of income estimates when classifying the segment[1]. People are often classified as "middle-class" simply because they are in the middle of the income distribution in their country's population. That does not mean they enjoy anywhere near the spending power of the middle-class segments in developed markets. A business strategy that targets this very large "middle-class" group in Asia involves a very difficult and complex set of inter-related factors and networks, characterised by high-volume, low-cost structures and narrow margins. Such a strategy requires well-researched local-market insights, adaptation of familiar business models, development of local supply chains, and patient management of endemic organisational challenges and institutional voids. These all fit poorly with Western business models and most Australian companies' mindsets and natural competitive advantages.

Instead of trying to fit square pegs into round holes, Australia should be more pro-active in enticing the significant and growing pool of Asia's *nouveau riche* US-dollar millionaires to manage a portion of their personal wealth portfolios in Australia. While the consumption behaviour of Asian millionaires can vary significantly across key segments depending on the source and age of their wealth, and their education and exposure to the West, their investment priorities are remarkably similar. Most share a strong, innate desire to seek some portfolio diversification away from their home market to a 'safe haven'. Australia is well positioned for this, especially given our stable governance and financial systems. We should leverage our relatively pristine environment and stable governance to become the "Switzerland of Asia" or "Singapore with a big outdoor playground". We should be promoting Australia as a secure location for Asia's rich to park some of their wealth.

The world's wealth distribution is highly skewed. Credit Suisse estimates that around 32 million USD millionaires have garnered more than 40% of the world's total wealth. At nearly US$100 trillion, this is three times more wealth than belongs to the more than a billion "middle-class" in the world. (See Figure 1 below.)

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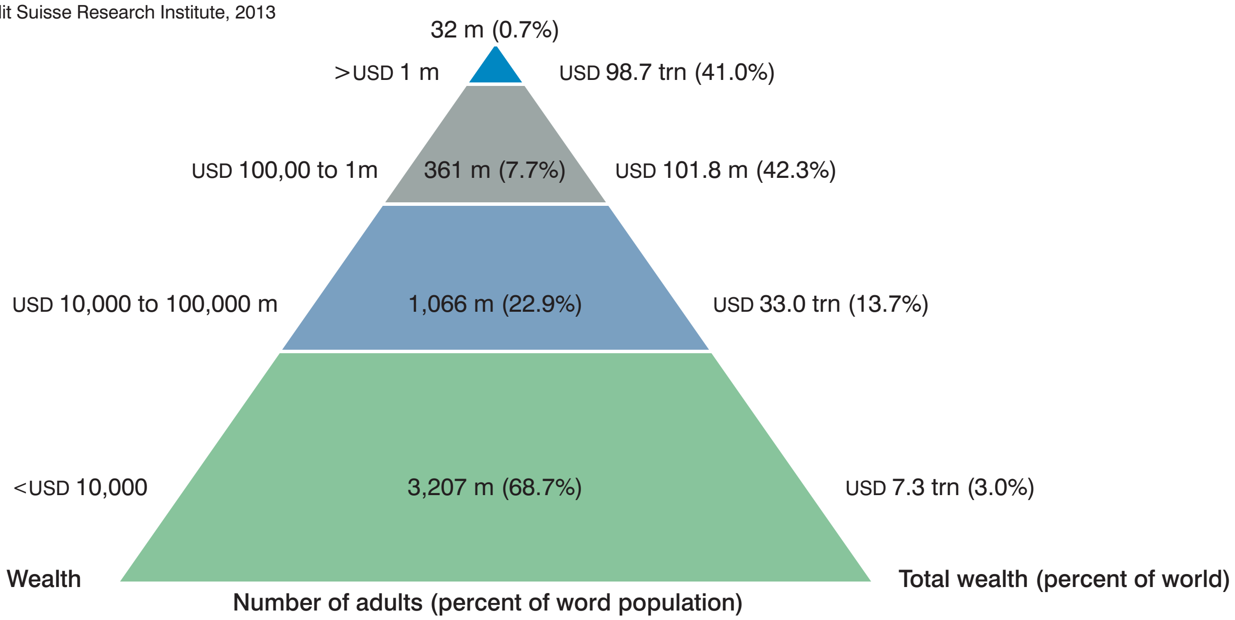
1. For example analysis by McKinsey & Co considers the mass middle class in China based on annual household incomes of US$10,000–$17,500, whereas the Asian Development Bank defines the middle-class range for many Asian markets as consuming on average US$700 to $7,000 per annum.

Figure 1: The global wealth pyramid
Source: Credit Suisse Research Institute, 2013



Asia's USD millionaires[2] are a sizeable and rapidly growing subset of this global wealth: there are around 6.5 million of them today and forecast to be more than 11 million by 2018. (See Figure 2.)

If Australia can attract a fair share of this wealth it could infuse more than US$4–5 trillion into the economy. This estimate is based on the extrapolation of around 11 million millionaires in the Asia-Pacific, China and India. It assumes each of them has a wealth portfolio of US$1.5–2.5 million and that Australia can attract, say, 15–25% of this as assets under management, in competition with Asia's other leading money-management centres of Hong Kong, Singapore and Dubai. This US$4–5 trillion infusion would more than triple the current largely domestic assets of around US$2 trillion in the Australian wealth-management industry. Australia's funds

Figure 2: Number of millionaires in 2013 and 2018 (regions and selected countries)

	Number (thousands)		Change
	2013	2018	(%)
USA	13,216	18,618	41
France	2,211	3,224	46
UK	1,529	2,377	55
Germany	1,735	2,537	46
Brazil	221	407	84
Korea	251	449	79
Mexico	186	273	47
Singapore	174	235	35
Indonesia	123	194	58
Russia	84	133	58
Hong Kong	103	168	63
Turkey	102	158	55
Poland	45	85	89
Malaysia	38	67	76
Chile	54	86	59
Africa	90	163	81
Asia-Pacific	5,266	9,074	72
China	1,123	2,112	88
Europe	10,236	15,027	47
India	182	302	66
LAC	569	936	64
North America	14,213	20,001	41
World	31,680	47,614	50

Source: Credit Suisse Research Institute, 2013

2. Defined here as the sum of millionaires categorised under Asia-Pacific, China and India. Note the wealth threshold criterion is net of their personal liabilities but does not include their primary residential home asset value.

management industry is nearly three times as big as key Asian alternatives such as Hong Kong and Singapore, but the Australian industry is predominantly domestic funds whereas the latter are mostly managing foreign wealth.[3]

This alternative strategy of targeting Asia's rich:

- Is in sync with our comparative advantages (clean environment, low population, stable governance and strong financial systems, alongside our well-developed tertiary services sectors such as tourism, leisure and recreation, education and health-care)
- Can contribute meaningfully to our economic growth, especially given uncertainties beyond the mining boom, concerns about our rapidly declining manufacturing industry and stagnant retail sector, and debates about the reasonable limits of population and economic growth that Australia's ecosystem can sustain
- Builds on our (relatively recently acquired) understanding of Asia's profound role for our long-term future.

Australia's trade and people linkages are increasingly dominated by Asia. HSBC Global Research points out that "... the Australian economy's strong Asian trade links extend to population flows, with migrants from Asia accounting for the largest share of inflows and Asia dominating growth in education and tourism exports". Australia is an increasingly attractive destination for Asians to live and go on holiday.

But our financial/investment links are still dominated by Western economies, as shown in the tables below (Figures 3a and 3b):

Australia's trade and people linkages are increasingly dominated by Asia.

3. Source: (Austrade, June 2010)

Figure 3a: Foreign investment in Australia is Western dominated

Source: HSBC Global Research 12 February 2013

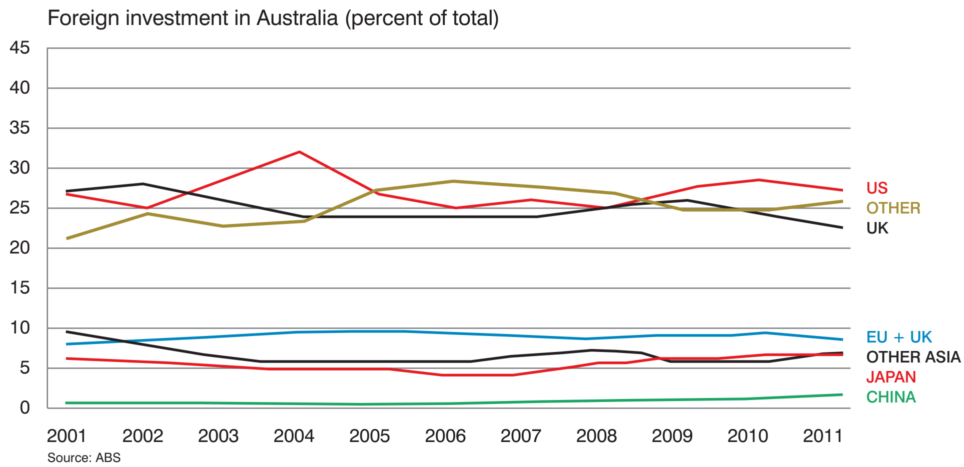
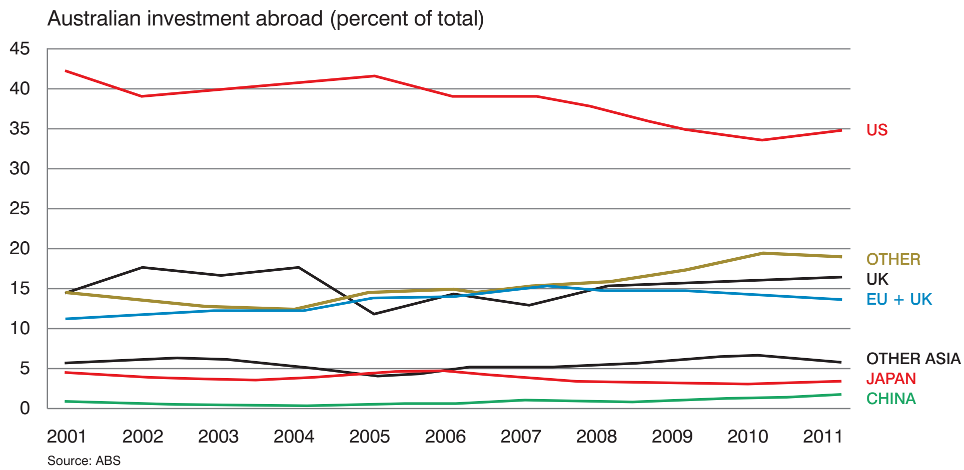


Figure 3b: Australian investment abroad mostly in the West

Source: HSBC Global Research 12 February 2013



Imagine what the estimated $4–5 trillion investment inflows from Asia's millionaires could do to boost the sophistication and effectiveness of our financial services sector, and what it would imply for the strength and stability of our economy and currency.[4]

At estimated annual management fees of about 2% of assets under management, this would translate to a direct boost to Australia's GDP of US$80–100 billion per year through a direct impact on our wealth management and property sectors and additional multiplier and trickle-down benefits for other sectors. With Australia's total GDP at around US$1.5 trillion, this additional US$80–$100 billion would nearly double the direct contribution to GDP of our financial services sector and would be twice as large as the existing direct GDP impact from our travel and tourism sector.[5] It would be a significant counter-balance to the mining sector and a major source of economic activity for the financial centres of Australia's eastern seaboard.

So what would it take to make this happen? The parking of a proportion of Asian wealth in Australia is already occurring to some extent by default – our real estate market prices and activity are clearly influenced by this. But it is fair to say we are neither effectively managing this situation, nor being proactive or systematic about better directing this opportunity towards bigger investments and wider asset classes.

This proposed new approach is not the same as the state and federal schemes aimed at attracting investment through business migration, although these schemes are certainly an allied strategy. The main motivation for most Asian millionaires to be targeted is portfolio diversification to a politically, financially and environmentally stable haven that they can visit freely and often. They might also want their children to be educated in Australia and for some family members to establish a strategic foothold here. But most Asian millionaires might not want to migrate to Australia with all their assets and business interests, which is what the business migration schemes primarily promote.

Many key elements of Australia's comparative advantage are already in place. But the most significant stumbling block is that our tax rates are 3–5 times too high relative to competing money management centres such as Dubai, Singapore and Hong Kong, which are currently the clearly favoured wealth-management destinations for Asian millionaires. It is fair to say that Australia currently is not even in the race. Australian economic planners should recognise that it is worth gaining a significantly higher volume of assets under management in exchange for a lower tax rate.[6]

The only other hurdle we need to overcome is our mindset – our quintessentially Australian egalitarian culture makes us intuitively focus on the middle class. Can we overcome this cultural discomfort and embrace the economic opportunity that Asia's *nouveau riche* can offer.

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4. If economic policy planners do not want the Australian dollar to strengthen through this investment inflow, there are a number of ways to avoid such an impact. For example, Australian fund managers could be allowed to manage investors' funds in a basket of other currencies, as with the offshore banking services offered by Hong Kong and Singapore.
5. Source: World Travel & Tourism Council, November 2013
6. This need not imply any reduction in the overall tax collection amount – given Australia's small population of taxpayers and the lower median incomes of Australian taxpayers, relative to the number of targeted Asian millionaires and the quantum of their potential wealth inflows to our economy. Additionally there are a number of alternative approaches, albeit more complex, to make it more tax effective for foreign investors to park their wealth in Australia without necessarily altering tax rates for Australian resident taxpayers.

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